

# The Importance of the EBITDA Calculation in Business Valuation

*Investors focus on net income, revenue, and cash flow to measure the financial health and value of companies. Learn why EBITDA is also an important factor.*

LONG BEACH, CA, UNITED STATES,  
August 3, 2021 /EINPresswire.com/ --  
What is EBITDA?

EBITDA stands for Earnings Before Interest, Taxes, Depreciation, and Amortization. EBITDA measures the company's overall financial performance. It is often used as an alternative to other metrics, including earnings, revenue, and income.



The Importance of the EBITDA Calculation in Business Valuation

“

Windes offers Advisory support for both M&A Strategy, as well as Value Acceleration & Exit Planning needs.”

*Christy E. Woods, CPA, MST*

EBITDA focuses on the financial outcome of operating decisions by eliminating the impact of non-operating management decisions, such as tax rates, interest expenses, and significant intangible assets.

Consequently, the measure gives a figure that clearly reflects the operating profitability of a business that can be compared with other companies by owners, investors, and stakeholders. It is for this reason that EBITDA is often preferred over other metrics when deciding which business is more attractive.

## EBITDA in Business Valuations

EBIT is one of the many EBITDA variations. The main difference between EBIT and EBITDA is the number of steps taken to reach a relevant and meaningful value that helps owners and stakeholders make decisions based on the company's financial health.

EBIT or Earnings Before Interest and Tax represents the value of earnings without the effect of tax rates and interest. EBITDA takes it a step further by removing and identifying depreciation and amortization expenses as well. Both EBIT and EBITDA come in handy to understand the

bigger picture of a company's value by breaking down different expenses and their impact on the business's worth.

In addition to EBIT, there are several other variations of EBITDA, including EBIAT (Earnings Before Interest After Tax), EBIDA (Earnings Before Interest, Depreciation, and Amortization), EBITDAR (Earnings Before Interest, Tax, Depreciation, Amortization and Restructuring/Rent Costs), EBITAC (Earnings Before Interest, Taxes, Depreciation, Amortization, and Coronavirus) and more. All values help build a picture of the company's value.

Potential buyers and investors generally employ EBITDA and its variations to compare the valuation of different companies. On the other hand, business owners can benefit from EBITDA by using it to enhance their exit strategy and take numerous business decisions, particularly operating decisions.

EBITDA is also compared with Seller's Discretionary Earnings (SDE) that is used to determine the historical cash flow of the business. Think of it as a recasting process that starts with net profit. The owner's salary and noncash profits are then added to the net profit. SDE is similar to EBITDA. The main difference that settles the EBITDA vs. SDE debate relates to the size of the business. EBITDA is generally employed for larger corporations and organizations, whereas SDE is more suitable for smaller companies.

#### EBITDA Calculation: How to Calculate EBITDA?

Accurate EBITDA calculation is a key part of the overall company valuation. Accountants employ two formulas to calculate the EBITDA value.

$$\text{EBITDA} = \text{Net Profit} + \text{Interest} + \text{Taxes} + \text{Depreciation} + \text{Amortization}$$

$$\text{EBITDA} = \text{Operating Income} + \text{Depreciation} + \text{Amortization}$$

The information required for EBITDA calculation should be included in the company's income statement. Here it is important to reiterate the importance of accurate results as inaccuracy can result in over or undervaluation of the business and company's profitability. Therefore, it is advisable to invest in a reliable accounting system or consider working with experienced and trusted accountants when keeping your financials up to date to ensure accurate EBITDA analysis.

#### Evaluating EBITDA Calculation

EBITDA calculation is merely the first step. The next step is to determine if the EBITDA you have calculated reflects a good and profitable standing or not. Companies employ different measures to evaluate their EBITDA calculation and derive meaningful information. These measures include the following:

EBITDA Margin = Calculated EBITDA / Total Revenue

EBITDA Coverage Ratio: (EBITDA + Lease Payments)/ (Interest Payments + Principal Payments + Lease Payments)

## Adjusted EBITDA

The distinctions between EBITDA and adjusted EBITDA are minor, but they are important to understand. Adjusted EBITDA, in essence, normalizes this metric depending on a company's revenue and expenses. These can differ significantly among businesses, making it difficult for analysts and buyers to assess whether one is more enticing than another.

By standardizing cash flows and income and removing any anomalies, such as owner bonuses, redundant assets, rent paid above market value, etc., Adjusted EBITDA enables people to analyze multiple enterprises at once, regardless of variances in industry, geography, or other factors.

Accountants use any of the basic EBITDA formulas discussed above to calculate adjusted EBITDA. However, prior to this step, it is crucial to remove the costs associated with various irregular and one-time expenses that do not impact the daily business operations.

Standardizing EBITDA gives an adjusted or normalized EBITDA value that is easier to compare for different companies than EBITDA. It also allows businesses and individuals to compare the EBITDA of the company with the industry as a whole. Here is a list of common EBITDA adjustments:

- Non-operating income
- Noncash expenses
- Unrealized loss or gain
- Single-time loss or gain
- Litigation expense
- Donations and goodwill impairments
- Above market compensation for the owner (in private firms)
- Assets write-downs
- Gain or loss in foreign exchange

Companies typically determine Adjusted EBITDA on an annual basis for valuation analysis. However, businesses can also calculate Adjusted EBITDA on a quarterly basis for internal use or even monthly when anticipating a potential M&A transaction.

Windes offers Advisory support for both [M&A Strategy](#), as well as [Valuation & Exit Planning](#) needs. Check out our complete article on EBITDA for more information on [why it is important to calculate EBITDA](#), how you can increase company EBITDA, and more information about the benefits and limitations of using EBITDA for business valuation.

Windes Advisory

Windes

+1 844-494-6337

Advisory@windes.com

Visit us on social media:

[Facebook](#)

[Twitter](#)

[LinkedIn](#)

---

This press release can be viewed online at: <https://www.einpresswire.com/article/547943650>

EIN Presswire's priority is source transparency. We do not allow opaque clients, and our editors try to be careful about weeding out false and misleading content. As a user, if you see something we have missed, please do bring it to our attention. Your help is welcome. EIN Presswire, Everyone's Internet News Presswire™, tries to define some of the boundaries that are reasonable in today's world. Please see our Editorial Guidelines for more information.

© 1995-2021 IPD Group, Inc. All Right Reserved.